SUMMARY OF THE STATEMENT OF DOUGLAS S. KANTOR ON BEHALF OF THE NATIONAL ASSOCIATION OF CONVENIENCE STORES

APPLICATION FOR FEDERAL DEPOSIT INSURANCE FILED ON BEHALF OF PROPOSED WAL-MART BANK

April 10, 2006 Arlington, Virginia

The National Association of Convenience Stores (NACS) is opposed to Wal-Mart's application for a Utah industrial bank charter and we urge you to deny the company's application for Federal deposit insurance.

Wal-Mart's applications for an industrial bank charter and Federal deposit insurance magnify, and potentially exacerbate, all of the policy problems that arise out of the ILC loophole. Not only would this Wal-Mart Bank be free of regulation at the holding company level by the Federal Reserve Board, it would be so large that, simply as a function of size, it would mix banking and commerce to such an extent that it would raise fundamental questions about the overall structure of the U.S. banking system.

At the heart of this discussion is a basic question that ILC supporters have never adequately answered – if holding company level regulation by the Federal Reserve is not necessary for ILCs, why is it necessary for other state and federally chartered banks? We believe that such oversight is necessary – for both traditional banks and ILCs. The Federal Reserve has repeatedly warned of the dangers of ILCs, a threat that is magnified by the size and market power of Wal-Mart.

There is a temptation to assume that because Wal-Mart is large and has many assets, it is safe. We have seen this assumption proven wrong time and time again. In fact, if anything, U.S. economic history has often shown that a far different adage typically holds sway – the bigger they are, the harder they fall. General Motors, to cite just one example, has gone from a stalwart of the U.S. economy to difficult times, but we do not know how or if GM's troubles will affect its ILCs because GM is not subject to holding company level regulation by the Federal Reserve Board.

Wal-Mart appears at a superficial level to be on solid footing now, but there are signs of potential problems. Without Fed regulation we will be left guessing as to when those problems may impact the bank's operations. This leaves insufficient safeguards to ensure that this massive company will not endanger FDIC insurance.

In addition to the significant regulatory issues this application presents, there are the competitive threats that may cause direct problems for NACS members and their customers. With a Utah ILC charter, Wal-Mart Bank would be able to branch and enter into retail banking. Although the company claims this is not its intent, Wal-Mart's past attempts to get into the banking business show this is very likely its strategy.

If Wal-Mart gets into retail banking, it would effect a direct threat to NACS members. Wal-Mart's business practices and unparalleled size have already cost many local communities their small businesses and jobs. This threat would be magnified if local banks are run off, leaving Wal-Mart bank as the "local" source of capital for NACS members – in effect, forcing surviving local businesses to go to their biggest competitor (Wal-Mart) for deposits and loans. This would provide Wal-Mart with an even greater competitive advantage in both retail and banking, effectively restricting access to capital for NACS members and other local businesses – especially in smaller communities where, as a result of Wal-Mart's business tactics, there may be few banking alternatives for small retailers.

Because Wal-Mart Bank would be owned by a competitor, the conflict of interest inherent in the commerce/banking mix could force local retailers to essentially provide their business plans to their competition – Wal-Mart. The conflict of interest could also lead local retailers to change business plans, pricing structures and markets in order to secure financing. These changes might be required by the "lender" (Wal-Mart) and thus inherently suspect, or they might be steps taken by the businesses in order to smooth the way to secure financing. Either way, it would be a distortion of the market and potentially very harmful to the economic vitality of the individual business and the community as a whole.

The growing concern about this issue has lead to a movement across the country to take legislative action to block Wal-Mart from branching across state lines. A number of states are considering legislation that would prevent Wal-Mart from using an ILC charter to open bank branches within their borders. This legislative activity reflects deep uneasiness regarding the ILC loophole generally and Wal-Mart Bank in particular. While we applaud the state action on this issue, we believe the federal government should step in to set national policy regarding ILCs.

Wal-Mart's application should be denied because the company fails to meet the statutory criteria that the FDIC must consider in reviewing insurance applications under Section 6 of the Federal Deposit Insurance Act. In particular:

- By the terms of the company's ILC application, it is possible for Wal-Mart to enter into retail banking in the future, which could have a destructive impact on small businesses and local communities;
- Wal-Mart Bank would present a grave risk to FDIC insurance; and
- Wal-Mart faces financial risks.

NACS urges you to deny Wal-Mart's application because it does not meet the statutory criteria that the FDIC must consider and the likelihood that the company will enter into retail banking poses an unjustifiable threat to taxpayers, consumers, small communities, small businesses, FDIC insurance, and the soundness of our banking system itself.

NATIONAL ASSOCIATION OF CONVENIENCE STORES

STATEMENT OF DOUGLAS S. KANTOR

Before the

FEDERAL DEPOSIT INSURANCE CORPORATION

HEARING ON APPLICATION FOR FEDERAL DEPOSIT INSURANCE FILED ON BEHALF OF PROPOSED WAL-MART BANK

April 10, 2006

Arlington, Virginia

Thank you for the opportunity to testify today on behalf of the National Association of Convenience Stores (NACS) regarding the application by Wal-Mart Stores, Inc. (Wal-Mart) for federal deposit insurance for the company's proposed industrial loan corporation. The Wal-Mart application and the potential impact of a Wal-Mart bank on local communities and economies is a serious concern and we applaud you for holding this hearing.

NACS is a non-profit trade association representing the convenience store industry. The convenience store industry includes about 140,000 stores and employs more than 1.5 million people across the United States, yet most of these businesses are small, family-owned operations. In fact, 60 percent of convenience stores are owned by one-store operators. NACS is a member of the Sound Banking Coalition, a group of concerned organizations that have come together to try to close the industrial loan company (ILC) loophole to protect consumers and businesses against the competitive problems and the threat to FDIC insurance posed by ILCs. We associate ourselves with the testimony of the Sound Banking Coalition, and signed onto the Coalition's letters to the FDIC dated August 10 and 17, 2005. Like the Coalition, NACS is opposed to Wal-Mart's application for a Utah industrial bank charter and opposed to the granting of Federal deposit insurance to a Wal-Mart Bank.

Introduction

Wal-Mart Bank Could Threaten the Banking System and Local Economies

Wal-Mart's applications for an industrial bank charter and Federal deposit insurance magnify, and potentially exacerbate, all of the policy problems that arise out of the ILC loophole. Not only would this Wal-Mart bank be free of regulation at the holding company level by the Federal Reserve Board, it would be so large that, simply as a function of size, it would mix banking and commerce to such an extent that it would raise fundamental questions about the overall structure of the U.S. banking system. When you strip away the arguments about the regulation of ILCs by the FDIC and the states, you get a basic question that ILC supporters have never adequately answered – if holding company level regulation by the Federal Reserve is not necessary for ILCs, why is it necessary for other state and federally chartered banks? The arguments made by ILC supporters, if they were valid, would prove too much. They would demonstrate that the fundamental underpinnings of bank regulations for safety and soundness are unnecessary and an incredible waste of resources. Of course, in our view that is not the case. Indeed, consolidated supervision by the Federal Reserve is essential – and should apply to ILCs.

Beyond the regulatory questions this application presents, however, are the competitive threats that may cause direct problems for NACS members and their customers. Wal-Mart's business practices and unparalleled size have already cost many local communities their small businesses and jobs. This threat would be magnified if local banks are run off, leaving Wal-Mart Bank as the "local" source of capital for NACS members – its parent company's small-town competitors.

Although the company has narrowly drafted its application to make it appear as though it would use an industrial bank charter primarily to process internal transactions, it would be able to branch and enter into retail banking. This would effect a direct threat to NACS members. In fact, a careful examination of Wal-Mart's application and the company's past efforts to obtain a bank reveal that this application is the first step toward an expansion into retail banking.

NACS urges you to deny Wal-Mart's application because the very possibility that the company will enter into retail banking poses an enormous, unjustifiable threat to taxpayers, consumers, small communities, small businesses, FDIC insurance, and the soundness of our banking system itself.

Wal-Mart Fails to Meet Statutory Criteria for FDIC Insurance

Wal-Mart's application should be denied because the company fails to meet the statutory criteria that the FDIC must consider in reviewing insurance applications under Section 6 of the Federal Deposit Insurance Act.

Wal-Mart fails to meet these criteria for the following reasons, each of which I will address in the remainder of my testimony:

- By the terms of the company's ILC application, it is possible for Wal-Mart to enter into retail banking in the future, which could have a destructive impact on small businesses and local communities;
- Wal-Mart Bank would present a grave risk to FDIC insurance; and
- Wal-Mart faces financial risks.

1. Wal-Mart Bank Would Threaten Small Businesses and Local Communities

Although Wal-Mart claims that it will simply use the industrial bank charter to process credit card, debit card, and electronic check transactions from its retail locations, Wal-Mart is likely to pursue retail banking in the future. When asked whether shoppers could someday shop for mortgages at Wal-Mart, financial services director Tom McLean refused to say that Wal-Mart would not offer these types of retail banking services and replied instead, "We continue to look for what makes sense to the customer."[1]

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[1] Becky Yerak and Josh Noel, *Wal-Mart Plan Has Bankers on Edge,* Chicago Tribune, July 20, 2005, *available at* http://www.chicagotribune.com/business/chi-0507200160jul20,1,3606468.story?coll=business-utl.

The application is only the most recent in a series of unsuccessful attempts by Wal-Mart to enter the financial services industry – and all previous attempts have included a retail banking component. In 1999, Wal-Mart tried to purchase a small savings and loan company in Oklahoma, but was stopped by provisions of the Gramm-Leach-Bliley Act.[2] In 2001, it attempted to partner with the Canadian Toronto-Dominion Bank, but its application was rejected as deficient by the Office of Thrift Supervision.[3] The application with Toronto-Dominion explicitly noted Wal-Mart's plan to offer retail banking services in its retail stores. In fact, one of the deficiencies in the application was that the plan contemplated having retail cashiers function as bank tellers.

Most recently, in 2002, Wal-Mart filed an application to acquire an industrial bank in California. The effort met with resistance from those concerned about the mixing of banking and commerce, and was ultimately blocked by the California legislature.[4] While right now Wal-Mart is publicly stating that it seeks only to save the costs of a third party processor for retail transactions, its current application appears to us to be merely a continuation of its past efforts to enter into retail banking.

Granting Wal-Mart an industrial bank charter would allow it to immediately branch into more than 20 states under current law – and that number could easily grow. Wal-Mart is the largest company in America, with thousands of stores across the country.

We note that there is growing concern leading to a movement across the country to take legislative action to block Wal-Mart from branching across state lines. A number of states are considering legislation that would prevent Wal-Mart from using an ILC charter to open bank branches within their borders. Legislation in Iowa, Virginia and Maryland would ban ILC branches on the premises of an affiliate that is considered commercial in nature. Illinois,

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[2] Jenifer K. Nii, *Wal-Mart is Planning to Open a Bank in Utah,* Desertnews.com, July 19, 2005, *at* http://deseretnews.com/dn/view/0,1249,600149522,00.html.
[3] Christopher Leonard, *Retailer Seeking Banking Inroads,* Arkansas Democrat Gazette, July 20, 2005.
[4] Mark Anderson, *Wal-Mart Will Look Elsewhere to Buy Bank,* Sacramento Business Journal, Oct. 2, 2002.

Missouri, and Wisconsin bills would prohibit ILCs from doing any business in their states. Michigan and Pennsylvania would specifically bar branches of ILCs chartered in Utah. This legislative activity reflects deep uneasiness across the country regarding the ILC loophole generally and Wal-Mart Bank in particular. While we applaud the state action on this issue, we believe the federal government should step in to set national policy regarding ILCs.

The impacts Wal-Mart stores have had on local communities raise particular questions. When Wal-Mart opened three Sam's Club (Sam's) stores in Oklahoma, local gas stations were initially pleased due to the business generated by traffic traveling to and from the stores. Wal-Mart quickly usurped the opportunity by providing gas below wholesale prices at its own stores, and caused local gas stations to lose a large volume of sales. A federal judge in the Western District of Oklahoma enjoined and restrained Sam's from selling motor fuel below cost as defined by the Oklahoma Unfair Sales Act, and the Tenth Circuit affirmed.[5] According to the Tenth Circuit, the evidence showed that "because of the volume of Sam's gasoline sales and its below-cost pricing, competition was lessened in Oklahoma City [in much of the] area surrounding Sam's stores."[6]

The effect that Wal-Mart has had on local businesses should not be permitted to repeat itself in the banking industry. If community banks are destroyed, surviving local businesses would be forced to go to their biggest competitor for deposits and loans, providing Wal-Mart with an even greater competitive advantage in both retail and banking, effectively restricting access to capital for NACS members and other local businesses – especially in smaller communities where, as a result of Wal-Mart's business tactics, there may be few banking alternatives for small retailers. Because "Wal-Mart bank" would be owned by a competitor, the conflict of interest inherent in the commerce/ banking mix could force local retailers to essentially provide their business plans to their competition – Wal-Mart. The conflict of interest could also lead local retailers to change business plans, pricing structures and markets in order to secure financing. These changes might be required by the "lender" (Wal-Mart) and thus

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[5] *See Star Fuel Marts, LLC, v. Sam's East, Inc.*, 362 F.3d 639, 643 (10th Cir. 2004).
[6] *Id.* at 649.

inherently suspect, or they might be steps taken by the small business - the NACS member or other loan applicant - in order to smooth the way to secure financing. Either way, it would be a distortion of the market and potentially very harmful to the business prospects for the small business.

Thus, a Wal-Mart bank would have an adverse impact on local communities – including banks, other local businesses, their workers, and their customers - and the company's application must be denied because it fails to meet the needs of the community.

2. Wal-Mart Bank Would Pose a Threat to FDIC Insurance and the Banking System

There is a temptation to assume that because Wal-Mart is large and has many assets, it is safe. We have seen this assumption proven wrong time and time again. In fact, if anything, U.S. economic history has often shown that a far different adage typically holds sway – the bigger they are, the harder they fall. This has been the rule for most companies that have come to dominate the American landscape in the way that Wal-Mart has. Take Union Pacific Railroad as one example. In 1869, Union Pacific officials helped place the golden spike – in Utah – inaugurating the transcontinental railroad. Just 24 years later, the company declared bankruptcy. In 1890, Standard Oil controlled nearly 90 percent of the flow of refined oil in the United States. But 21 years later the company was broken up after the Supreme Court declared it an unreasonable monopoly. Enron, Worldcom, Kmart and others are more recent examples. In fact, the latest example is playing out before our eyes as we watch General Motors lose billions of dollars each year and dramatically cut its workforce to try to stay solvent. Fifty years ago no one would have believed that GM would be in the difficult situation it is in today. But it is. What will this mean for GM's ILCs? Without regulation by the Fed that is very hard to say. Perhaps the ILCs are sound and will remain so for years to come – but perhaps not. The problem is that no one really knows because even though GM owns more than one bank it is not subject to consolidated supervision. We are left to wait and see what the future holds. These examples do make one thing clear – size and large revenues do not guarantee safety.

Wal-Mart appears at a superficial level to be on solid footing now, but there are signs of potential problems and without Fed regulation we will be left guessing as to when those problems may impact the bank's operations.

Wal-Mart faces particular risks that other banks, not to mention many other commercial enterprises, do not. Prominent examples of these risks include financial risks due to foreign currency fluctuations, and fluctuations in oil prices. For example, Wal-Mart is exposed to substantial risk when there are fluctuations in the yuan. More than seventy percent of goods sold by Wal-Mart are made in China.[7] Xu Jun, Wal-Mart China's director of external affairs, has pointed out that China is Wal-Mart's most important supplier in the world and noted, "If Wal-Mart were an individual economy, it would rank as China's eighth-biggest trading partner, ahead of Russia, Australia and Canada."[8] More than 5,000 Chinese enterprises have established steady supply alliances with Wal-Mart.[9] The company has recently made public plans to open 20 stores in China, increasing its total number of stores in China to 56. In addition, the company reportedly plans to hire up to 150,000 additional employees in the country over the next five years.

The commercial ties between Wal-Mart and China pose special risks because China is loosening its artificial control of the valuation of its currency. On July 21, 2005, the Chinese government dropped the yuan-dollar peg and lifted the value of the currency by more than two percent. The revaluation raised the price of Chinese goods, pressuring profit margins on an enormous proportion of the products sold in Wal-Mart. While this first step in floating the yuan resulted in a relatively modest increase of the currency, economists have estimated that China's currency policy has kept the yuan undervalued by as much as forty percent.[10] AG Edwards advised its clients regarding the float of the yuan: "We believe that China's decision. . .will

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[7] Jiang Jingjing, *Wal-Mart's China inventory to hit US$18b this year,* China Business Daily, November 29, 2004, *available at* http://www2.chinadaily.com.cn/english/doc/2004-11/29/content_395728.htm.
[8] *Id.*
[9] *Id.*
[10] Dow Jones, *Retail Stocks Lower in 'minor' China Revaluation,* July 21, 2005.

have an immediate impact for U.S. retailers sourcing product out of China. U.S. retailers cost of goods sold will increase and, of course, their gross margins will decrease."[11] A sudden jump in the valuation of the yuan could have devastating consequences for Wal-Mart and, if Wal-Mart becomes as dominant in the financial services sector as it has been in other segments of the economy, a decision made in Beijing regarding the valuation of its currency could put a Wal-Mart bank and, by extension, the Bank Insurance Fund at risk.

Wal-Mart also faces risks from rising energy prices. Wal-Mart's stock price fell last year in reaction to increased oil prices and CEO H. Lee Scott, Jr. admitted to worries "about the effect of higher oil prices" on the bottom line. Higher energy prices increase Wal-Mart's costs of importing and transporting the extraordinary volume of goods it sells, as well as the risk that as consumers spend additional funds on fuel they will have less to spend on goods at Wal-Mart. As Mr. Scott said, "Our customer continues to be impacted by higher gas prices, and it is difficult to improve our expense leverage in the current environment." These financial risks faced by Wal-Mart are not common among banks and create unique problems due to the size and scope of Wal-Mart's worldwide supply network and operation.

China's currency policies and world energy prices may not seem like immediate threats to Wal-Mart. Some observers might deride the impacts that these and other trends may present, but keep in mind the GM example. There were many who, in the 1970s, scoffed at the notion that Japanese car makers could ever dent GM's market share in the United States. In hindsight we can easily see how GM's problems developed and how it and other U.S. companies underestimated their foreign competitors, but at the time it was very difficult to grasp the impact of the changes that were occurring. Given the rapid rate of change and the worldwide nature of our present economy, commercial companies like Wal-Mart are far more vulnerable to rapidly changing global trends now that they were in the past. Will Wal-Mart stay strong for many years? We just do not know. And that is precisely why regulation by the Fed is so important. Right now Wal-Mart is performing without a net. That is just fine and is what commercial

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[11] *Id.*

companies do. If this application is approved, however, we will have given them a net – FDIC insurance. But the strains on that safety net if Wal-Mart falls off of its high wire will be too great to justify.

Commenting on the impact Wal-Mart's size and influence already has on dependent suppliers, Tom Rubel, CEO of consultant Retail Forward Inc. predicted that "If [Wal-Mart] ever stumbles, we've got a potential national security problem on our hands. They touch almost everything....If they ever really went into a tailspin, the dislocation would be significant and traumatic."[12] A company this large should not be permitted to place our banking system and FDIC insurance at a similar risk.

The Federal Reserve Board and its chairmen past and present have voiced strong concerns about the potential implications of commercial companies engaging in banking through the ILC loophole. In testimony before the House Financial Services Committee last month, newly-appointed Federal Reserve Board Chairman Ben Bernanke urged Congressional review and action with respect to the regulation of ILCs. More recently, on March 1, 2006, Federal Reserve Governor Donald L. Kohn testified to the Senate Committee on Banking, Housing and Urban Affairs that, "the Board continues to believe that Congress should *not* grant this new (de novo) branching authority to ILCs unless the corporate owners of these institutions are subject to the same type of consolidated supervision and activities restrictions as the corporate owners of other full-service insured banks."

The Board's current policy is clearly consistent with the views of former Board Chairman Alan Greenspan, who spoke on the matter several times, most recently in a letter to Representative James Leach on January 6, 2006. In the letter to Rep. Leach, Chairman Greenspan described the current and growing threat to the nation's financial system posed by ILCs.

[12] Business Week, *Is Wal-Mart Too Powerful?,* Oct. 6. 2003, *available at* http://www.businessweek.com/magazine/content/03_40/b3852001_mz001.htm

> When this exemption was adopted in 1987, ILCs were mostly small locally owed institutions that had only limited deposit-taking and lending powers. However, much has changed since 1987 and recent events and trends highlight the potential for this exemption to undermine important general policies established by Congress that govern the banking system and to create an unlevel competitive playing field among banking organizations. The total assets held by ILCs have grown by more than 3,500 percent between 1987 and 2004, and the aggregate amount of estimated insured deposits held by ILCs has increased by more than 500 percent since 1999...[T]he ILC exemption is now the primary means by which commercial firms may control an FDIC-insured bank engaged in broad lending and deposit-taking activities and thereby breach the general separation of banking and commerce.
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> The character, powers and ownership of ILCs have changed materially since Congress first enacted the ILC exemption. These changes are undermining the prudential framework that Congress has carefully crafted and developed for the corporate owners of other full-service banks. Importantly, these changes also threaten to remove Congress' ability to determine the direction of our nation's financial system with regard to the mixing of banking and commerce and the appropriate framework of prudential supervision. These are crucial decisions that should not be made through the expansion and exploitation of a loophole that is available to only one type of institution chartered in a handful of states.

These risks are particularly significant because Wal-Mart, as an industrial bank, would not be subject to the same level of regulatory oversight as banks: the company would not face the same consolidated supervision at the holding company level; it would not be subject to consolidated capital requirements; and would be subject to arguably weaker regulatory enforcement. This leaves insufficient safeguards to ensure that this massive company will not endanger the Bank Insurance Fund. We question the rationale for this differential treatment of ILCs. As the GAO recently reported to Congress, ILCs "pose similar risks to the bank insurance fund as other types of insured depository institutions." In fact, the same GAO report went further, stating that "from a regulatory standpoint, these ILCs may pose more risk of loss to the bank insurance fund than other insured depository institutions operating in a holding company."

3. Wal-Mart Faces Financial Risks

One of the factors the FDIC is required to consider in determining whether or not to grant federal deposit insurance is "the adequacy of the depository institution's capital structure." Unfortunately, we are unable to comment on the company's current capital structure due to the inadequacy of the public information available in connection with Wal-Mart's application. We urge the FDIC to be more forthcoming with such information in light of the significant policy questions raised by Wal-Mart's application and its market dominance.

Although we are unable to comment on specific financials, we are aware of worrisome trends that could affect the company's financial condition, as well as that of a Wal-Mart bank. Wal-Mart is one of the most often-sued companies in history. These lawsuits create enormous potential liabilities that could threaten the company, and, if it acquires one, its bank.

The company's legal and regulatory issues are particularly concerning because, as an industrial bank, it would not be regulated by the Federal Reserve as are other bank holding companies. Therefore, the potential financial impact of these issues may not be detected in time to prevent financial problems before they endanger the bank and FDIC insurance. As Wal-Mart shareholders have themselves cautioned, "the risks associated with a compliance breakdown are especially onerous for Wal-Mart and its shareholders in light of the company's large size and market capitalization."[13]

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Wal-Mart's application for an industrial bank is troubling on many fronts. The company's application does not meet the basic legal requirements upon which the FDIC judges such applications and it would open so broadly the ILC loophole in the BHCA that the long-time separation of banking and commerce would no longer be a recognizable principle, threatening the FDIC insurance and the banking system generally.

We urge you to reject Wal-Mart's application.

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[13] Letter from William C. Thompson, Jr. at 2.